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No. 84-165

**In the Supreme Court of the United States**

OCTOBER TERM, 1984

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W. GEORGE GOULD, PETITIONER

v.

MAX A. RUEFENACHT, ET AL.

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE THIRD CIRCUIT

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**BRIEF FOR THE SECURITIES AND  
EXCHANGE COMMISSION  
AS AMICUS CURIAE SUPPORTING RESPONDENT**

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### **QUESTION PRESENTED**

Whether the sale of a 50% stock interest in a company is a securities transaction subject to the anti-fraud provisions of the federal securities laws.

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**INTEREST OF THE SECURITIES  
AND EXCHANGE COMMISSION**

The Securities and Exchange Commission submits this brief as amicus curiae to address a significant issue under the federal securities laws—whether the sale of conventional stock in a business corporation is excluded from the coverage of those laws where the purchaser acquires a degree of control over the corporation. The Third Circuit held that conventional stock necessarily is a “security,” and, hence, that a transaction involving such stock is covered by the antifraud provisions of the securities laws, regardless of whether there is a transfer of control. That court thereby joined the Courts of Appeals for the Second, Fourth, and Fifth Circuits in rejecting the “sale of

business" doctrine,<sup>1</sup> which has been adopted by four other circuits.<sup>2</sup>

The Commission agrees with the analysis and conclusion of the court below. While the present case involves the transfer of a 50% stock interest, it raises the same concerns as its companion case, *Landreth Timber Company v. Landreth*, cert. granted, No. 83-1961 (Nov. 13, 1984), which involves the transfer of a 100% stock interest. As we urged in our amicus curiae brief in *Landreth*, where a person is defrauded in the purchase or sale of a well-defined instrument that is enumerated in the statutory definitions of "security" in the federal securities laws, the availability of a cause of action under the antifraud provisions of those laws should not turn on questions of control. Regardless of the percentage purchased or sold, persons who choose to deal in instruments such as conventional stock and bonds should be able to know—without a hearing—that the antifraud provisions of those laws are applicable. Neither the Commission, in enforcing the antifraud provisions, nor defrauded private parties should be required to litigate whether conventional debt or equity securities also meet the test for securities in the form of investment contracts.

<sup>1</sup> *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir.), cert. denied, 444 U.S. 868 (1979); *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983); see also *Cole v. PPG Industries, Inc.*, 680 F.2d 549 (8th Cir. 1982) (interpreting Arkansas law by reference to the federal securities laws).

<sup>2</sup> *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (9th Cir.), cert. granted, No. 83-1961 (Nov. 13, 1984); *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977).

## STATEMENT

In early 1980, respondent Max A. Ruefenacht purchased 2,500 shares of newly issued common stock of Continental Import and Export, Inc., thereby becoming a 50% shareholder in the company (Pet. App. 5a). Prior to the transaction, Joachim Birkle, Birkle's wife, and a company that Birkle controlled were Continental's sole shareholders (Pet. App. 5a; Amended Complaint ¶ 5C). Following his purchase of the stock, respondent took an active although part-time role in Continental's affairs, while remaining a full-time employee of another company (Pet. App. 6a). Birkle remained Continental's president (Pet. App. 5a).

Respondent brought this action under the antifraud provisions of the federal securities laws,<sup>3</sup> alleging that he had purchased the Continental stock in reliance on misrepresentations concerning the company's financial condition, projected earnings, and material contracts (Pet. App. 6a-7a). Petitioner W. George Gould, Continental's counsel and a director of the company, was named as one of the defendants (Amended Complaint ¶ 5E). Following an evidentiary hearing on the extent of the control respondent acquired in connection with the stock purchase, the district court entered summary judgment for the defendants on the basis of the sale of business doctrine (Pet. App. 46a-47a, 51a-52a). In the view of that court, respondent's

<sup>3</sup> The antifraud provisions relied upon by respondent are Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. 77l(2) and 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. Respondent also alleged claims under 15 U.S.C. 77l(1) based on registration violations, and he alleged pendent state law claims as well.

purchase of Continental stock was not a securities transaction because the stock failed to meet the test for a security in the form of an investment contract—in particular, the requirement that profits from the enterprise be derived from the efforts of others (Pet. App. 48a).

The court of appeals reversed. It held that the investment contract test does not apply to conventional common stock. Characterizing stock as a “well-defined” term, the court concluded (Pet. App. 42a; see *id.* at 23a) that the sale of business doctrine is contrary to the language, structure, and legislative history of the securities laws, is inconsistent with underlying policy, and derives from a misunderstanding of *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

## SUMMARY OF ARGUMENT

### I.

The sale of business doctrine conflicts with the language of the federal securities laws, their structure, and their legislative history. Petitioner seeks to excise from the definition of “security” in the securities laws the quintessential security, common stock in a business corporation, and to engraft onto the statute a new requirement—that each transaction involve an investment in a common enterprise with profits to be derived from the efforts of others. This proposed exercise in judicial legislation disregards the statutory language, which enumerates a variety of financial instruments, including “stock,” as securities. Petitioner’s analysis also conflicts with the legislative scheme, which regulates private transactions and transfers of corporate control. Moreover, the legislative history demonstrates that in enacting the secu-

rities laws, congressional concern was not limited to the protection of “passive” investors. Thus, there is no warrant in the legislative record for excluding purchasers of conventional securities simply because they are able to obtain information concerning the corporation or intend to play a subsequent role in corporate management.

### II.

The sale of business doctrine finds no support in this Court’s prior decisions. While the Court has used a transactional test in determining whether the securities laws apply to instruments of an unusual nature, it has not suggested that such a test is required in the case of conventional instruments. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), makes clear that purchasers of instruments bearing traditional names such as stock, and embodying significant characteristics associated with those instruments, may reasonably rely on the applicability of the federal securities laws. Nor does this Court’s decision in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), support the sale of business doctrine. The Court in that case relied on the language “unless the context otherwise requires,” which precedes the definitional sections of the securities laws, in excluding a certificate of deposit—an instrument covered by comprehensive federal banking laws—from the anti-fraud provisions of the securities laws. This case, in contrast, involves stock, which is not covered by another federal regulatory scheme.

### III.

Nor do policy considerations favor the sale of business doctrine. Adopting that doctrine would generate wasteful litigation directed to the threshold issue of

what constitutes a security in each particular factual setting, engender uncertainty in the application of the law and create arbitrary and unfair results. It might also call into question the status of other instruments, including debt obligations, that have always been considered securities. Finally, significant legal distinctions between sales of stock and sales of assets support the conclusion that purchasers of stock have the protections of the antifraud provisions of the securities laws.

### ARGUMENT

Petitioner posits that, in enacting the federal securities laws, Congress intended principally to protect "passive" investors and that, accordingly, this Court should limit the coverage of those laws to advance that purpose only. To this end, petitioner asks the Court to adopt, as the exclusive definition for all securities, the test designed to identify "investment contracts," one of the many types of instruments enumerated in the statutory definition of "security." The exercise in judicial legislation which petitioner proposes would require the Court to disregard the plain statutory language, misconstrue the legislative history, and ignore its prior decisions construing those statutes, in order to reach a result that is unsound as a matter of policy.

#### I. THE SALE OF BUSINESS DOCTRINE IS CONTRARY TO THE LANGUAGE, STRUCTURE, AND LEGISLATIVE HISTORY OF THE FEDERAL SECURITIES LAWS

A. "Security," as defined in Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1), and in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), includes both specific

terms, such as "stock," and more general terms, such as "investment contract."<sup>4</sup> See *SEC v. W. J. Howey Co.*, 328 U.S. 293, 297-299 (1946). As discussed in the Brief of the Securities and Exchange Commission as Amicus Curiae Supporting Petitioner (at 711), in *Landreth Timber Company v. Landreth*, No. 83-1961 [hereinafter cited as SEC Landreth Br.], to use the test for "investment contract"<sup>5</sup> to determine the status under the securities laws of "stock"—a separate term in the definition—violates established canons of statutory construction. As the court below correctly recognized, the notion that a catch-all statutory term like "investment contract"—designed to broaden the Acts' coverage by ensuring that novel, unconventional or irregular instruments would come within the concept of a security—instead *circumscribes* the more specific term "stock," "turn[s] the

<sup>4</sup> Section 3(a)(10) of the Securities Exchange Act provides:

The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement, \* \* \* investment contract, voting-trust certificate, \* \* \* or in general, any instrument commonly known as a "security" \* \* \*.

Section 2(1) of the Securities Act is virtually identical. See *Marine Bank v. Weaver*, 455 U.S. 551, 555 n.3 (1982). All 40 definitions in the Securities Exchange Act, and all 15 definitions in the Securities Act, are preceded by the phrase, "When used in this [chapter], unless the context otherwise requires \* \* \*" (see pp. 15-16, *infra*).

<sup>5</sup> The Court in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975), defined an investment contract as "an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."

history of the Acts \* \* \* on their heads" (Pet. App. 22a).<sup>6</sup>

In urging the use of a test that looks to the character of the transaction, rather than the nature of the instruments, petitioner erroneously attempts (Br. 22-23) to analogize "stock"—a specific and precise term in the statutory definition—to "note"—a vague term capable of referring to a variety of commercial, consumer, and investment instruments. See SEC Landreth Br. at 10-11. As the court below correctly observed, "there is \* \* \* some necessity for fine-tuning the definition of 'note' to avoid sweeping within the coverage of section 10(b) of the 1934 Act every consumer and business loan financing current operational costs. But there is no such necessity in the stock area" (Pet. App. 13a-14a). Once a court determines that instruments are conventional stock, "the paradigm of a security" (*Daily v. Morgan*, 701 F.2d at 500), it should end its inquiry and hold that the instruments are securities.

B. There is little need to speculate about congressional intent. Even apart from the definitional sections, the federal securities laws themselves refute the fundamental premise underlying the sale of business doctrine—that private, negotiated transactions and transfers of corporate control are outside the intent of those statutes.

<sup>6</sup> This Court has repeatedly declined invitations to restrict the meaning of the Acts' general terms because of the more specific terms such as "stock" that precede them. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943); *Tche-repnin v. Knight*, 389 U.S. 332, 343 (1967). By incorporating the "investment contract" analysis into the proposed test for determining whether "stock" is a "security," petitioner seeks essentially to swallow the specific terms into the general.

Congress considered private transactions in connection with the Securities Act of 1933. Rather than omit them from the coverage of that Act, as petitioner implies (Br. 24-25), Congress chose to strike a balance between the need for antifraud protection and the desire to minimize the burden on the transacting parties. Thus, the drafters of the Securities Act expressly exempted private, negotiated transactions from the registration provisions, but not from the antifraud provisions. See Sections 4, 12(2), and 17(a) of the Securities Act, 15 U.S.C. 77d, 77l(2), 77q(a). The Securities Exchange Act reflects a similar judgment. See Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b); *Daily v. Morgan*, 701 F.2d 496, 502 (5th Cir. 1983) ("Congress \* \* \* chose to apply the section 10(b) antifraud provision to all stock" without exempting small, private sales). Accordingly, "the Act has always been understood to apply to transactions in shares of close as well as publicly held corporations and to negotiated as well as market sales and purchases of shares." *Golden v. Garafalo*, 678 F.2d 1139, 1146-1147 (2d Cir. 1982) (citing *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971)); see *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982).

Contrary to the tenor of petitioner's position (Br. 13), the Securities Exchange Act includes provisions directed to the transfer of controlling stock interests. For example, the Act expressly provides for the regulation of tender offers (transactions designed to acquire corporate control), for the disclosure of transactions by persons who control corporations (such as directors, officers, and principal stockholders), and for the recovery of short-swing profits garnered by such persons. See, e.g., Sections 14 and 16 of the Securities

Exchange Act, 15 U.S.C. 78n and 78p. Petitioner cannot contend that these provisions should be read out of the statute on the ground that they deal with a subject matter of no interest to Congress. These provisions show that, in fact, petitioner misunderstands the scope of the securities laws.<sup>7</sup>

C. The legislative history of the federal securities laws likewise provides no justification for the sale of business doctrine. See SEC Landreth Br. at 13-14. While petitioner correctly points out (Br. 8) that Congress was concerned with the protection of investors, this Court recognized in *United States v. Naftalin*, 441 U.S. 768, 776 (1979), that this was by no means Congress' sole concern. Rather, the report of the Senate Committee on Banking and Currency recited a number of legislative goals for the 1933

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<sup>7</sup> Because private transactions and those affecting corporate control are expressly covered by provisions of the Securities Exchange Act, they are clearly within the "public interest" advanced by the antifraud provisions of Section 10(b). See Br. 21. Furthermore, petitioner's suggestion (Br. 21) that that term should be narrowly construed ignores half a century of judicial construction holding that Section 10(b) and Rule 10b-5 "should be construed 'not technically and restrictively, but flexibly to effect [their] remedial purposes.'" *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-387 (1983) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

Likewise, the placement of Section 10(b) (15 U.S.C. 78j(b)) between Section 9 (15 U.S.C. 78i), prohibiting manipulative activities on national securities exchanges, and Section 11 (15 U.S.C. 78k), prohibiting certain trading by brokers, dealers, and exchanges, in no way demonstrates that Section 10(b) covers only these same persons and activities. See Br. 21 n.8. To the contrary, Section 10(b) is expressly concerned with "any security registered on a national securities exchange or any security not so registered \* \* \*."

Act.<sup>8</sup> Moreover, petitioner's characterization of the term "investor" as synonymous with "passive investor" (Br. 13) conflicts with common usage. To "invest" means simply "[t]o lay out (money or capital) in business with the view of obtaining an income or profit; to convert into some form of wealth other than money, as securities or real estate, with the expectation of dividends, rentals, etc.; as to *invest* money in stocks." *Websters' New International Dictionary of the English Language* 1306 (2d ed. 1934) (emphasis in original); accord, Funk & Wagnalls, *New Standard Dictionary of the English Language* 1289 (1932). This definition does not exclude those whom petitioner refers to as "entrepreneurs."

Nor does the legislative history support petitioner's theory (Br. 13) that Congress intended to protect purchasers of conventional securities only if (1) they cannot "obtain or confirm relevant firsthand information" about the business; and (2) they must rely "virtually entirely upon others for management of the enterprise." The first prong of petitioner's proposed test would probably exclude persons who purchase se-

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<sup>8</sup> The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.

S. Rep. 47, 73d Cong., 1st Sess. 1 (1933).

curities through brokerage firms having research departments, as well as virtually every institutional investor, regardless of the size of its investment. The second prong, which looks to events subsequent to the purchase, is equally inapposite. By the time a defrauded purchaser obtains a voice in corporate management, any false representation has achieved its purpose—the purchaser has already invested his money. The fraud respondent alleges was “in connection with” his stock purchase and related to the condition of the corporation and the value of its shares at the time of purchase. At that time, he had no control over the corporation or its policies. Furthermore, the possibility of fraud is not eliminated simply because a person buys or sells a controlling stock interest. Nor is a purchaser of a controlling interest necessarily able to “mitigat[e] the effects of fraud” (Br. 13). Indeed, the size of such a purchase may instead exacerbate the effects of fraud.

## II. PRIOR DECISIONS OF THIS COURT DICTATE REJECTION OF THE SALE OF BUSINESS DOCTRINE

Far from validating the major exercise in judicial legislation needed to uphold petitioner’s position (see Br. 15), prior decisions of this Court—like the structure of the statutes and their legislative history—counsel deference to the statutory language. As this Court acknowledged in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 n.19 (1976) (quoting *Addison v. Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 617-618 (1944)):

To let general words draw nourishment from their purpose is one thing. To draw on some unexpressed spirit outside the bounds of the normal meaning of words is quite another. \* \* \* After

all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him.

To deny that conventional stock is a security requires a departure from the words of the statute that no decision of this Court suggests.

A. Petitioner claims that this Court’s past decisions support the use of the investment contract test in cases involving conventional common stock. But the Court’s inquiries into the definition of a security have all concerned “unusual” instruments (*Marine Bank v. Weaver*, 455 U.S. at 559). See SEC Landreth Br. at 18-19 & n.18. While it was necessary to apply a transactional test to determine whether these unusual instruments were securities, the decisions do not suggest that such time-consuming analysis is either requisite or useful in the case of more conventional instruments. To the contrary, this Court has suggested that, in some cases, “proving the document itself, which on its face would be a note, a bond, or a share of stock” will establish coverage. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943). Furthermore, a purchaser may justifiably assume that the federal securities laws apply when the instrument bears a traditional name such as “stock” or “bonds” and “embodies some of the significant characteristics typically associated with the named instrument.” *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 850-851 (1975).

This is just such a case. Unlike the cooperative housing “stock” at issue in *Forman*, the stock purchased by respondent embodies the indicia typically associated with stock: (1) “the right to receive

'dividends contingent upon an apportionment of profits'; (2) negotiability; (3) the ability to be used as collateral; (4) "voting rights in proportion to the number of shares owned"; and (5) share appreciation. *Id.* at 851 (citation omitted); Pet. App. 7a.<sup>9</sup> The purchaser of such instruments would regard them as stock precisely because in "economic reality" they are stock.

Seizing on language in *Forman*, petitioner erroneously asserts (Br. 31-32) that controlling shareholders "use or consume" the corporation's assets. While the purchaser of so-called stock for the purpose of obtaining living quarters, as in *Forman*, clearly intends to "use or consume" his purchase (*Forman*, 421 U.S. at 853), a purchaser of stock in a business corporation clearly does not.<sup>10</sup> By its nature, conventional stock—

<sup>9</sup> The district court rejected the argument that "because Continental is a closed corporation and its stock has certain limitations common to such corporations" the stock was not within the statutory definition (J.A. 47a). See also *id.* at 50a ("the stock which Ruefenacht received contains all the attributes mentioned by the *Forman* Court as indicating that the transaction did involve a security").

<sup>10</sup> A shareholder cannot "use or consume" corporate assets with impunity. A manager who appropriates corporate assets to personal use would violate a fiduciary duty to other stockholders as well as proscriptions against self-dealing. See generally 1 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 31, at 346 (rev. 1983); 12B W. Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 5806, 5807, 5810-5812 (rev. 1984); *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971) (quoting *Pepper v. Litton*, 308 U.S. 295, 307 (1939)). Treating corporate assets as personal property may also permit corporate creditors to "pierce the corporate veil" and hold the controlling shareholder liable for corporate tort or contract obligations. See generally 1 Fletcher, *supra*, at §§ 41.10-41.60.

whether it represents a small fraction or a controlling block of the outstanding shares—confers a proportional voice in corporate management. *Forman*, 421 U.S. at 851. One who acquires a greater percentage of stock will naturally acquire a more substantial voice, reflecting the greater portion of the corporate capital that his investment represents. The exercise of that voice should hardly disqualify him from anti-fraud protection. As the court below observed (Pet. App. 33a): "Many investors may elect to participate in the management of a business in order to enhance their return on investment \* \* \*." See also SEC Landreth Brief at 15-19 (further explaining why *Forman* militates against petitioner's petition).

B. In urging an interpretation contrary to the statutory language and legislative history, petitioner, citing *Marine Bank v. Weaver*, *supra*, relies on the prefatory clause "unless the context otherwise requires," which precedes all of the Acts' definitions. As explained more fully in the SEC Landreth Brief at 19-21, *Weaver* concerned the interplay between two comprehensive regulatory schemes; it authorizes no case-by-case inquiry into the equities and supposed legislative purpose for each application of the federal securities laws. Moreover, petitioner, who relies on the "context clause" to argue that the antifraud provisions are not applicable in the case of an instrument within the plain terms of the statute, "has the burden of showing that the 'context otherwise requires.'" *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1137-1138 (2d Cir. 1976) (emphasis in original). The context of the present case—which involves no alternative federal regulatory scheme, and in which respondent's interest comes within the fundamental congressional purpose of protecting pur-

chasers and sellers of securities—does not justify a departure from the statutory language.<sup>11</sup>

### III. SIGNIFICANT POLICY CONSIDERATIONS ALSO COUNSEL REJECTION OF THE SALE OF BUSINESS DOCTRINE

The court of appeals aptly noted (Pet. App. 29a) that adopting the sale of business doctrine would render sellers and purchasers unable to predict when the securities laws applied, which in turn “raises the cost of economic transactions, inhibits the flow of capital, spawns litigation, and in general benefits neither the parties nor the courts.” As discussed in SEC Landreth Br. at 21-27, that doctrine creates substantial uncertainty in the application of the law, arbitrary distinctions between participants in the same transactions, and unfair results. The problem of unpredictability which we there discuss is exacerbated in cases such as the present which involve the transfer of much less than 100% of a corporation’s stock.<sup>12</sup>

<sup>11</sup> In a similar situation in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 389-390 & n.88 (1982), this Court refused to exclude from the antifraud protection of Section 4b of the Commodity Exchange Act defrauded purchasers of commodities futures who engaged in speculation rather than hedging. Relying in part on the similarity between the language of that provision and that of Section 10(b) of the Securities Exchange Act, the Court stated: “[T]his Court has recognized an implied cause of action under the Securities and Exchange Commission’s Rule 10b-5 on behalf of all securities traders.” 456 U.S. at 389 n.88 (emphasis supplied).

<sup>12</sup> Petitioner takes the position (Br. 26) that conventional stock is not stock for purposes of the securities laws where the purchaser “obtains significant control” or “actively participates in the enterprise.” If obtaining control is a dis-

In such cases the sale of business doctrine requires evidence on the threshold issue of whether the purchaser obtained control.<sup>13</sup>

qualification, institutional investors or speculators who purchase a block of stock sufficient to confer a measure of control would have no antifraud protection against unscrupulous sellers. At the least, they would face the prospect of a threshold inquiry into whether their purchase conferred control in light of a multitude of factors such as the number and dispersion of shareholders. See *Golden v. Garafalo*, 678 F.2d at 1146. See also Thompson, *The Shrinking Definition of a Security: Why Purchasing all of a Company’s Stock is not a Federal Security Transaction*, 57 N.Y.U. L. Rev. 225, 258 (1982) (proposing at least seven factors that courts applying the “sale of business” doctrine should consider). If participation in the company is the test, the courts would necessarily become embroiled in such questions as “whether part-time managers are passive or active, what classification to accord controlling shareholders who intervene sporadically, and the status of new investors who assume ambiguous roles as employees or who intend initially to remain passive but are soon forced into management roles.” *Golden v. Garafalo*, 678 F.2d at 1146. See SEC Landreth Br. at 21-23. At the conclusion of this burdensome and unnecessary exercise, only the threshold question of whether the stock is a security will have been resolved.

<sup>13</sup> Petitioner’s argument (Br. 30) that rejection of the sale of business doctrine will open the “floodgates” and lead to federal jurisdiction over “an infinite number of garden-variety commercial transactions involving stock” is overstated and inaccurate. Since courts assumed until very recently that all transactions involving stock were “securities” transactions (see Carson, *Application of the Federal Securities Acts to the Sale of Closely Held Corporations by Stock Transfer*, 36 Me. L. Rev. 1, 3 & n.17 (1984)), rejection of the sale of business doctrine should result in little or no increase in the workload of the federal courts. But adoption of the doctrine will lead to additional hearings on the issue of control.

Petitioner's theory (Br. 23) that no instrument can qualify as a security unless it meets the test for an investment contract would create problems even beyond the sale of business context. The requirement under that test of profits from the entrepreneurial or managerial efforts of others has been a stumbling block in various lower court cases where the status of debt instruments paying fixed interest has been at issue. Some courts have expressed doubt that debt instruments such as long-term corporate bonds could meet the "profits" requirement of the investment contract test. See *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484 (7th Cir. 1984); *Briggs v. Sterner*, 529 F. Supp. 1155, 1168 (S.D. Iowa 1981); *Hamblett v. Board of Savings & Loan Associations*, 472 F. Supp. 158, 165 (N.D. Miss. 1979).

Finally, the sale of business doctrine fails to recognize significant legal distinctions between a sale of stock and a sale of assets. For example, "one who purchases the stock in a corporation—a separate legal entity—assumes ownership of a business with both assets and liabilities," while one who purchases assets may generally avoid assuming liabilities and debts (*Daily v. Morgan*, 701 F.2d at 504). The possibility of hidden liabilities and obligations that may accompany the purchase of intangibles such as stock calls for a higher degree of protection for the purchaser. As this Court has noted, the securities laws were enacted in the face of a growing recognition that the common law of fraud governing chattels and realty is "ill-suited" to the sale of securities. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). Persons like respondent who bargain for the purchase or sale of one of the very instruments the securities laws were designed to cover should have the protections of those laws.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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